4. Certification Procedures Should Ensure That <u>Franchise Authority Has The Right To Regulate.</u>

a. The cable operator should have the right to challenge the franchise authority's effective competition showing.

The 1992 Cable Act clearly establishes a preference for competition over regulation.[100] However, paragraphs 17 and 23 of the Notice propose to rely on data submitted by the franchise authority without any direct means for the cable operator to challenge the finding of no competition during the thirty-day certification procedure. It is facially unfair to preclude cable operators from an opportunity to present evidence directly to the Commission concerning competing multichannel video programming distributors. Surely, the franchising authority has little concern for defending the interests of the cable operator in its certification since it will gain regulatory power unless effective competition is found. However, the cable operator has a statutory right to be free from regulation if the Commission finds that no effective competition exists. Thus, the cable operator should be accorded due process to present evidence in its own behalf to the Commission before the thirty-day period expires. This presentation of evidence does not need to involve a "full pleading cycle,"[101] but merely the right to make a written presentation of evidence that the operator is subject to

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[100]47 U.S.C. § 543(a) ("Competition Preference"); 47 U.S.C. § 543(a)(2) ("Preference for Competition").

[101]Notice at ¶ 23.

effective competition. Since it is likely that very few cable systems will be deemed to have effective competition,[102] no undue administrative burden is likely to result from a requirement to afford fundamental due process to cable operators.

b. Standardized certification form should provide evidence of legal authority to regulate and the absence of effective competition.

Nashoba agrees with the tentative conclusion of paragraph 19 of the Notice that a standardized form for certification that is served on the cable operator prior to submission to the FCC is appropriate. The form found at Appendix D of the Notice is generally acceptable with the exception of two items. First, question 4(a) should ask the franchising authority to state the exact statute and to quote the provisions in the franchise agreement that enable the franchising authority to regulate basic cable service rates. Second, the form should require that the franchising authority provide evidentiary support for the statement of no effective competition. As the Notice tentatively concludes, "this form should include a section for the authority's statement and explanation of its initial finding that effective competition is lacking, with reference to documentable data, including any submissions made to the Commission."[103] The Appendix D form should be amended to include this statement and explanation.

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[102] See 47 U.S.C. § 543(l).

[103] Notice at ¶ 19.

C. Basic Rate Formula.

Under the 1992 Cable Act, the Commission must adopt regulations designed to ensure that basic cable rates are "reasonable."[104] At a minimum, Congress has directed the FCC, in crafting such regulations, to account for the following factors: (i) rates charged by systems that are subject to effective competition; (ii) direct costs of delivering basic service; (iii) the appropriate allocation of joint and common costs found to be "reasonably and properly allocable to basic"; (iv) advertising and any other revenue derived from basic; (v) franchise fees and taxes; (vi) PEG access support costs; (vii) reasonable profit; and (viii) the costs of retransmission consents.[105]

In order to ensure that basic cable rates are reasonable, the Commission has proposed adopting either: (i) a benchmark rate or rate formula; or (ii) a cost-based approach, under which an individual system's costs would be examined following traditional cost of service principles and its rates then set to permit an appropriate rate of return.[106] In deciding among these approaches, the Commission must keep in mind the 1992 Cable Act's requirement that regulations governing basic rates must reduce administrative burdens on subscribers, cable operators,

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[104] 47 U.S.C. § 543(b)(1).

[105] Id. at § 543(b)(2)(C).

[106] Notice at ¶ 33.

franchising authorities, and the Commission.[107] This requirement can be best achieved by (1) making basic rate standards virtually self-effectuating; (2) adopting a simple formula whereby reasonable rates can be calculated with certainty based upon empirical factors without reference to system cost figures or other specific financial data;[108] and (3) allowing cable operators subject to basic rate regulation to immediately implement basic rate increases, subject to challenge by the franchising authority.

1. Rate Of Return Regulation Would Be Inappropriate.

The Commission has previously rejected cost-based rate of return regulation due to its inherent flaws:

> Conventional rate of return regulation has a number of drawbacks that would appear to be equally applicable in the cable television context. This method of regulation is not only administratively cumbersome but, because it interferes with incentives to operate efficiently, may also fail over the long run to assure consumers the lowest reasonable rates for the services to which they subscribe.[109]

Congress has also reached the same conclusion, stating in the 1992 Cable Act's legislative history that "[t]he Committee is concerned that several of the terms used in this section are

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[107] 47 U.S.C. § 543(b)(2)(A).

[108] See Notice at ¶¶ 53-56.

[109] Notice of Proposed Rulemaking in CC Docket No. 87-313, 2 FCC Rcd 5208, ¶ 39 (1987); Notice of Inquiry in MM Docket No. 89-600, 5 FCC Rcd 362, ¶ 45 (1989); Further Notice of Proposed Rulemaking in Docket No. 87-313, 3 FCC Rcd 3195, 3217-28 (1988); Report and Order and Second Further Notice of Proposed Rulemaking in Docket No. 87-313, 4 FCC Rcd 2873, 66 RR 2d 372, 382, 390 (1989).

similar to those used in the regulation of telephone common carriers. It is not the Committee's intention to replicate Title II regulation."[110] Congress also rejected this type of regulation in Section 621(c) of the 1984 Cable Act, which is left intact by the 1992 Cable Act: "[a]ny cable system shall not be subject to regulation as a common carrier or utility by reason of providing any cable service."[111] Accordingly, Nashoba agrees with the Commission's preliminary conclusion that cost-based rate of return regulation is a choice of last resort,[112] which should be turned to only as a fail-safe to avoid confiscatory rates.

Rate of return regulation discourages risk taking and innovation, since profits are capped on successful innovations.[113] As a result, the firm delays modernization and the introduction of new technology.[114] Such consequences in the cable industry would be seriously detrimental.[115]

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[110]House Report at 83.

[111]47 U.S.C. § 541(c) (1984).

[112]Notice at ¶¶ 33, 39, 40, 57-59.

[113]See National Telecommunications and Information Administration, Regulatory Alternatives Report at 18-21 (1987).

[114]See A. Kahn, The Economics of Regulation: Principles and Institutions, Vol. I, at 117-18 (1970).

[115]Industries subject to rate of return regulation, such as the electric utility and railroad industry, have failed to experience technological achievements. In fact, several railroads have gone bankrupt under rate of return regulation, and in recent years two major electric utilities (Public Service of New Hampshire and El Paso Electric Company) have entered bankruptcy proceedings.

Furthermore, rate of return regulation is likely to distort the regulated firm's decision making process and encourage rate base padding.[116] As a result, under this type of regulation, basic rates would never be as reasonable as they could be.[117] For this reason alone, rate of return regulation of the cable television industry would be contrary to the purpose of the 1992 Cable Act.[118]

Another major concern regarding cost-based rate of return regulation is the incentive to shift the costs of non-regulated competitive activities onto regulated services.[119] As the chairman of the Missouri Public Service Commission has stated:

> Cross-subsidization of non-regulated enterprises by regulated utility services is a major issue for regulators today, and assuring ourselves and the consuming public that this does not occur requires more than just a cursory review of a company's operations. Frequently these reviews and audits require large commitments of time and resources.[120]

The administrative burdens imposed by rate of return regulation are also significant, requiring the regulator to judge

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[116] Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195 at 3214-15.

[117] Id.; Notice of Inquiry, 5 FCC Rcd 362, ¶ 45.

[118] See House Report at 83 ("[t]he purpose of Section 3 is to create a tier of low cost basic cable service").

[119] See Report and Order and Second Further Notice of Proposed Rulemaking (Price Cap Regulation of AT&T) in CC Docket No. 87-313, 66 RR 2d 382, 392 n.101.

[120] McClure, Kenneth, Chairman, Missouri Public Service Commission, "The Drawbacks of Competition," Public Utilities Fortnightly, November 1, 1992, at 51.

complex cost allocation methodologies, demand predictions, comprehensive earnings data, and changing technological developments. The significant costs of the necessary bureaucracy would be borne by the public, either directly through higher rates,[121] or indirectly through higher taxes or reduction in other government services. These practical realities are anathema to a fundamental directive from Congress that the Commission must "seek to reduce the administrative burdens on subscribers, cable operators, franchising authorities, and the Commission.[122]

Finally, the overwhelming trend by the Commission and other regulatory agencies has been to phase out rate of return regulation.[123] It would be paradoxical if the Commission would initiate in 1993 a regulatory approach for the cable industry

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[121]See "Cable Act Could Force Industry into Uniform Accounting, Speakers Say," Communications Daily, December 15, 1992, at 2 (quoting estimates that basic cable rates could quadruple under rate of return regulation).

[122]47 U.S.C. § 543(b)(2)(A), (B); see also House Report at 83.

[123]Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice in CC Docket No. 87-313, 4 FCC Rcd 2873 (1989), Erratum, 4 FCC Rcd 3379 (1989), modified on recon., 6 FCC Rcd 665 (1991), rev'd in part on other grounds, AT&T v. FCC, 974 F. 2d 1351 (D.C. Cir. 1992); New York Tel. Co., Case 28691, Opinion No. 85-17 (N.Y.P.S.C. 1985), on reh. Opinion No. 85-17A, 74 PUR 4th 590 (N.Y.P.S.C. 1986). See also "Bush Signs Energy Law," Electric Light & Power, December 1992, at 1; Manjeet Kripalani, "Electric Utilities," Forbes, January 4, 1993, at 134.

that has fallen out of favor throughout the world.[124] Indeed, the legislative history of the 1992 Cable Act expressly demonstrates Congressional direction for the Commission to avoid cost of service regulation:

> The Committee is concerned that several of the terms used in this section are similar to those used in the regulation of telephone common carriers. It is not the Committee's intention to replicate Title II regulation. The FCC should create a formula that is uncomplicated to implement, administer, and enforce, and should avoid creating a cable equivalent of a common carrier 'cost allocation manual.'[125]

We agree, however, with the Commission's tentative conclusion that the cost of service approach to basic rate regulation should be utilized in one limited circumstance -- as a "safety net" "for cable operators seeking to justify the reasonableness of rates that do not meet our primary benchmarking standard."[126] As the Commission recognizes, there may be instances where a cable operator cannot meet the benchmark rate because certain costs not included in the benchmark are especially high for that operator. As the Commission concludes, in such circumstances the cable operator should be able to demonstrate such costs to the franchising authority or the

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[124]A. Irvin and R. Peters, "Do Incentives Work?" Public Utilities Fortnightly, June 15, 1992, at 18 ("[t]his makes incentive regulation opponents just about the last advocates of a command economy [i.e., rate of return] in the Western World").

[125]House Report at 83.

[126]Notice at ¶¶ 33, 39.

Commission, in order to obtain relief from the benchmark.[127] Unless the cable operator could utilize this "safety net," it would face confiscatory rates, a result that neither the Congress nor the Commission intended.[128]

2. A Benchmark Approach Appears To Be The Best Alternative.

We thus agree with the Commission's tentative conclusion to adopt a benchmark approach to basic rate regulation because an appropriately crafted benchmark approach "could achieve reasonable rates at lower costs and with less administrative burdens than could traditional cost-of-service regulation."[129] The Notice describes a "benchmark" as a price against which a given cable system's basic rate would be compared. "The benchmark would permit identification of systems with presumptively unreasonable rates, while establishing a zone of reasonableness for systems with rates below the benchmark."[130]

Specifically, we believe that benchmarks should be calculated on a per-channel basis, both for administrative

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[127] Id. at ¶ 59.

[128] See id. at nn.66, 79; 138 Cong. Rec. S14583 (Sept. 22, 1992) (statement of Sen. Lieberman). See generally Federal Power Comm'n v. Texaco Inc., 417 U.S. 380, 391-92 (1979); Matson Navigation Co. v. Federal Maritime Comm'n, 959 F.2d 1039, 1051 (D.C. Cir. 1992).

[129] Notice at ¶ 33.

[130] Id. at ¶ 34.

ease[131] and to account for differences in sizes of basic offerings. The concept of a per-channel benchmark is correctly based on the idea that one overall basic service rate could not possibly reflect the various costs different cable operators face, or the differing value of each basic offering which depends largely on the number of services offered. Thus, a "low" or "reasonable" basic rate, as intended by Congress[132] is not an absolute number, but rather a relative term based on such cost and value components. A per-channel benchmark comprised of the appropriate factors would reflect both of these components while furthering Congress' goal of providing incentives for cable operators to add services to basic beyond the statutory minimum.

However, the per-channel benchmark should not be combined with any overall cap on the basic service rate or left to the franchising authority to decide whether additional discretionary services must be included on the basic level. Otherwise, the per-channel rate would become meaningless for cable systems with numerous must-carry or PEG access stations or which are improperly forced to carry discretionary services without adequate compensation. For example, if the per-channel benchmark

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[131]While some precision might be sacrificed by a simple basic rate formula, Notice at ¶ 36, we believe that a more complex formula would be an administrative nightmare. We also agree with the Notice that a simple formula "would protect consumers from excessive rates and, by eliminating the need for detailed cost-based regulation in many jurisdictions, would keep the costs of administration and compliance low." Id.

[132]See House Report at 62-63.

is set as one dollar, but the overall basic rate is capped at thirteen dollars, systems with over thirteen channels required on the basic tier would not be able to charge the per-channel benchmark rate. For the same reasons, unless the benchmarks were calculated on a per-channel basis with no overall basic rate cap, cable operators would have no incentives to add programming to the basic service level beyond the minimum statutory requirements, and indeed would have incentives to remove any programming services off basic that were not statutorily required.[133] The benchmark also should have a "floor," similar to a telco subscriber line fee, to reflect the extensive fixed, joint and common costs associated with connecting any subscriber.

Rather than applying a detailed cost of service analysis, a benchmark approach would identify certain empirical criteria so that cable systems could be separated into distinct classes, thus providing more reliable comparisons among similarly situated systems. The Notice seeks "comment on what variables should be used for defining the classes of systems to which a different benchmark rate should apply."[134] We suggest the following factors, many of which were mentioned in the Notice,[135] as characteristics that would appropriately group together similar

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[133]See House Report at 82 (expressing Congress' intent "to permit cable programmers to be fairly compensated for the service they provide to cable subscribers and to encourage cable systems to carry such services on the basic tier").

[134]Notice at ¶ 37.

[135]Id.

cable systems for purposes of establishing fair benchmarks and which would serve as reliable proxies for identification of major factors which can affect basic cable rates:

(a) Activated channel capacity. We believe that thirty six channels would be an appropriate dividing line between higher and lower capacity systems. This would be consistent with the exemption for systems with less than thirty six activated channels from the requirement to provide commercial leased access.[136]

(b) Density. Generally, the lower the density (number of subscribers per route mile), the more expensive to build and operate the system, because of the extra labor, equipment, wiring, etc. required to connect a given number of homes, as well as fewer potential customers among which to spread the costs. Fifty subscribers per mile might provide a reasonable density benchmark dividing line.

(c) Age of plant. Newer plant (e.g., less than seven years old) obviously reflects higher costs and more modern technology.

(d) Percent of aerial vs. underground cable. Underground cable systems are generally more expensive to build, operate, and maintain. Accordingly, we believe that a cable system with forty percent or more underground cable should be categorized as "heavily" underground.

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[136] See 47 U.S.C. § 532(b)(1)(D).

(e) System size (i.e., number of subscribers). Depending, of course, on other costs of doing business, smaller system have fewer subscribers over which to spread their costs, so that each individual subscriber's rate could be higher than for otherwise similarly situated larger systems. Accordingly, we believe that a 10,000 subscriber cutoff would equitably separate larger cable systems from smaller ones.

(f) MSO size. This factor could account for large variances in cable system costs, including programming acquisition, equipment, capital, etc. In this regard, the top five MSOs should comprise the first category due to their size, followed by MSOs six through fifty, then MSOs below fifty.

(g) Off-air broadcast signal availability. The Commission has conducted and analyzed comprehensive studies which verify that off-air broadcast signal availability is perhaps the most significant factor in measuring demand for cable television.[137] While Congress has admittedly rejected off-air broadcast availability as the sole test for effective competition, the fact that systems with fewer broadcast signals

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[137]Report in MM Docket No. 89-600, 5 FCC Rcd 4962, ¶¶ 50-52, 59-66 (citing M. Bykowsky & T. Sloan, NTIA Staff Report, "Competitive Effects of Broadcast Signals on the Price of Basic Service," (1990); R. Crandall, "Regulation, Competition and Cable Performance," (1990); J. Dertouzos and S. Wildman, "Competitive Effects of Broadcast Signals on Cable," (1990)); See also FCC 1985 Staff Study, Alternative Criteria for Defining Effective Competition: A Statistical Analysis of Small Cable Markets, at 3 ("FCC 1985 Staff Study"); FCC Mass Media Bureau, Policy and Rules Division, Staff Report, Cable System Broadcast Signal Carriage Survey Report, Sept. 1, 1988 ("FCC 1988 Staff Report").

available off-air must charge higher basic rates cannot be ignored.

(h) Regional cost of labor index. As the Notice recognizes, this is "another important adjustment factor" that represents "a general change in the cost of doing business."[138]

One factor that should not be incorporated into the benchmark is advertising revenue earned from the provision of basic service. If such revenue is offset against permissible rates, cable operators will be discouraged from including more cable programming networks on the basic level, contrary to Congressional intent.[139] This will in turn have a detrimental effect on cable's commitment to local advertising.

3. Benchmark Alternatives.

(a) Effective competition. Examining rates charged by systems subject to effective competition[140] would not provide the best basic rate benchmark. First, the sample size would be too small. For example, even if such systems could be identified, which, as the Commission acknowledges, may be difficult,[141] there are probably less than twenty five active overbuilds in the U.S. today. This small number is no accident -- as numerous studies have demonstrated, most overbuilds are

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[138]Notice at ¶ 38.

[139]See House Report 82.

[140]See Notice at ¶¶ 41-43.

[141]Id. at ¶¶ 17-18, n.73.

characterized by short term disequilibrium rates, cross-subsidization, and below-cost pricing. In the typical overbuild, neither cable operator makes a profit, and one of the systems ultimately goes out of business or sells out to its competitor, or both systems sell out to a third party.[142] Furthermore, although systems that face effective competition due to low penetration may be greater in number, the data obtained from such systems may be skewed due to low density, a small subscriber base, and other demographic factors that characterize these systems.[143]

(b) Past regulated rates. The Notice suggests that previously regulated rates may be presumed to be reasonable because they "resulted from a competitive bidding process for the franchise and subsequent rate adjustments were made under local franchise authority oversight."[144] The Commission has tentatively chosen 1986 as the point for examining past regulated rates,[145] offering as the only explanation for its choice that

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[142]See, e.g., Samuel H. Book, Ph.D., "Do Overbuilds Make Sense?" Cable Marketing, November, 1987, at 34; Touche Ross & Co., "Report on Overlapping Cable Franchise Study," October 7, 1987; Malarkey-Taylor Research, "Economic Analysis of Cable System Overbuilds," January 1987; Touche Ross & Co., "Financial and Economic Analysis of the Cable Television Permit Policy of the City and County of Denver," Dec. 23, 1983; George L. Page, "CATV Systems Overbuild Considerations Relevant to Liberty Cable Television's Application for Franchise Renewal," November 1982.

[143]See FCC 1985 Staff Study; FCC 1988 Staff Report; Report and Order in MM Docket No. 84-1296, 58 RR 2d 1, 29 (1985).

[144]Notice at ¶44.

[145]Id.

1986 was the last time basic cable rates were regulated by local franchising authorities.[146] However, 1986 is not an appropriate index date for numerous significant reasons.

First, Congress has expressed its preference for a low-cost basic tier, a so-called "lifeline" service which is only required to contain off-air broadcast signals and PEG access channels,[147] although the cable operator should have discretion to add additional services where economically prudent. In 1986, however, cable operators were often including a multitude of cable networks and superstations with their basic offerings. The presence of these newly-created services, many of which were financed through equity infusions from the cable industry as well as fees paid by cable operators, would obviously skew any analysis of 1986 prevailing rates since basic offerings in 1986 may not bear much resemblance to the reconfigured basic service level upon implementation of the 1992 Cable Act.

Second, as the Notice points out, 1986 rates reflected the effects of the urban market "bidding wars" for cable franchises, many of which resulted in artificially low rates which proved not to be economically sound. Indeed, such unrealistic and unattainable effects of municipal avarice in the franchising

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[146] Id.

[147] 47 U.S.C. § 543(b)(7)(A).

process is one of the primary factors leading to deregulation under the 1984 Cable Act.[148]

Third, 1986 historical rates would lead to anomalous results because the sample would include both regulated and unregulated rates. 1986 regulated rates were artificially low, having lagged well behind the Consumer Price Index for the prior two decades.[149] On the other hand, local rate regulation was optional in 1986, and literally hundreds of enlightened franchising authorities had concluded that the costs and disadvantages of cable rate regulation outweighed the benefits.

A more accurate index date for past regulated rates, therefore, would be December 31, 1975. As of that date, basic service closely resembled the statutorily defined, basic level subject to regulation by the 1992 Cable Act,[150] because the only satellite-delivered programming service was Home Box Office and there were thus no cable networks or superstations on basic to skew the rates. Moreover, FCC regulations in effect on that date required that the basic rates of all cable systems be subject to

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[148] See 1984 House Report at 21-22.

[149] Oversight of the Cable Communications Policy Act of 1984: Hearings Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science and Transportation, 101st Cong., 1st Sess. 51 (November 16, 1989) (Statement of James P. Mooney, President, National Cable Television Association); Bureau of Labor Statistics, Consumer Price Index, U.S. City Average, 1972 through 1986.

[150] See 47 U.S.C. § 543(b)(7)(A).

local regulatory review.[151] Thus, the sample would not be skewed by inclusion of both regulated and unregulated basic rates. Finally, such data is readily available from the 1976 edition of the Television and Cable Factbook, Services Volume. In order to make up for the fact that basic rates were artificially suppressed from 1975 to the present, the rate could be adjusted upward for inflation, construction and rebuild costs (as contemplated by the Notice),[152] and costs of compliance with the Copyright Act of 1976, which was enacted subsequent to December 31, 1975.

(c) Current average rates. This benchmark would perhaps be a workable approach. As contemplated by the Commission, cable system per-channel rates would be compared against an average and "would be considered reasonable if they did not exceed that average by more than some fixed amount."[153] However, not all basic rates were unreasonable when the 1992 Cable Act was passed. Accordingly, the "reasonable" line should be drawn at some point well above the current average.

(d) Cost of service. This benchmark would be unworkable for the same reasons set forth above demonstrating that cost of service is inferior to benchmarking as a method of rate regulation.

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[151] 47 C.F.R. § 76.31(a)(4) (1974).

[152] Notice at ¶¶ 44-45.

[153] Id. at ¶ 46.

(e) Price caps. This benchmark would "define reasonable increases in rates for the basic tier."[154] We believe this is not an effective benchmark for several reasons. If a cable operator has been a "good actor" by keeping rates at or below the benchmark ultimately adopted by the Commission, there is no reason to believe it will suddenly impose excessive rate increases. Price caps would indeed punish operators with the lowest rates, by limiting their ability to raise rates to the benchmark, which, by definition, is a reasonable price that such operators should be permitted to charge. Moreover, price caps will encourage (and indeed already have encouraged) cable operators to raise rates prematurely to avoid artificial price cap limits which may be imposed.[155]

4. Adjustments To The Basic Rate Benchmark.

As the Commission recognizes, the benchmark would need to be adjusted over time to account, for instance, for "appropriate empirical or market considerations."[156] Accordingly, we believe that the basic rate benchmark should be adjusted annually to account for cost pressures on the cable industry. The Notice proposes the CPI as a possible index for such adjustment.

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[154] Id. at ¶ 49.

[155] See, e.g., Henry Gilgoff, "What Should Cable Cost?" Newsday, March 15, 1992, at 60 (City ed.); Diane Duston, "Cable TV Rates Rise, One More Time," Baltimore Sun, Dec. 21, 1992; Jay Greene, "New Year to Bring Higher Cable TV Rates," Cleveland Plain Dealer, Dec. 19, 1992.

[156] Notice at ¶ 34.

However, although widely available, it covers the economy as a whole and thus may not be the most accurate indicator. If available, the local Service Price Index might be more accurate.[157] Perhaps the most accurate indicator would be the "admissions" component of the CPI, which measures the price of some of cable's chief competitors, including movies, theater, sports events, and concerts. The admissions CPI is readily available from the U.S. Department of Labor's Bureau of Labor Statistics.

In sum, a per-channel benchmark for basic cable service, based on current average basic rates or historical rates as of December 31, 1975, annually adjusted for inflation and other market factors, would appear most likely to successfully achieve Congress' goals of a reasonably priced basic service level that cable operators would want to add to, and an easily administrable formula to ensure that the rates for such service remain reasonable.

D. Regulation Of Rates For Equipment.

The 1992 Cable Act establishes two distinct approaches for evaluating the rates charged by cable operators for various types of equipment provided to cable subscribers. Specifically, pursuant to Section 623(b)(3), the Commission's basic rate regulations are to include rate standards for "installation and lease of the equipment used by subscribers to receive the basic

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[157] See id. at ¶ 38.

service tier," as well as "installation and monthly use of connections for additional television receivers [AOs]".[158] Pursuant to Section 623(c), on the other hand, the Commission's regulations applicable to cable programming services (or "tiers") are to include "installation or rental of equipment used for the receipt of such video programming."[159] Equipment utilized solely to receive pay or a la carte services would remain outside either standard and would continue to be deregulated.

1. Only Equipment Used Solely To Receive Basic Service Is Regulated Based On Actual Cost Pursuant To Section 623(b)(3).

As the Notice correctly points out, the 1992 Cable Act clearly distinguishes between regulation of rates for equipment used to receive basic service and equipment used to receive cable programming services.[160] One key difference is that regulation of equipment used to receive basic service involves pricing based on actual cost.[161] This criterion was intended to ensure that the rates for basic equipment are reasonable. Oversight of rates

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[158] 47 U.S.C. § 543(b)(3)(A), (B).

[159] Id. at § 543(c)(2), (l)(2).

[160] Notice at ¶ 64.

[161] 47 U.S.C. § 543(b)(3). Pricing based on actual cost does, however, include a reasonable profit. See id. at § 543(b)(2)(C)(vii); Conf. Report at 63 ("[t]he conferees agree that the cable operators are entitled to earn a reasonable profit"). The purpose of the "actual cost" basis "is to require cable operators to price these items fairly, and to prevent them from charging prices that have the effect of forcing subscribers to purchase these items several times over the term of the lease." House Report at 83-84. A reasonable profit is fully consistent with this goal.

associated with cable programming service, including equipment used to receive such service, involves cost as only one of several factors to be considered.[162] These are precisely the same factors that the FCC must consider in evaluating complaints alleging that non-basic service rates are unreasonable. Unlike basic equipment regulation, the issue under Section 623(c) is whether the non-basic equipment rates are so egregious and out of range as to be found to be "bad actor" rates. In other words, the presumption is that the rates for non-basic equipment are reasonable absent a finding that they fall within a narrow unreasonableness test designed to "rein in" a small class of outliers. Thus, the clear intent of the 1992 Cable Act is to provide two different approaches to rate scrutiny, based upon the type of service being provided, and to subject only equipment required solely to receive basic service to pricing based on actual cost.

This intent to have different standards for basic, non-basic, and premium service-related equipment is further evidenced by an examination of Section 623(b)(3)(A), which specifies the two types of equipment that must be priced as basic equipment (i.e., based on actual cost): (1) equipment "used by subscribers to receive the basic service tier," and (2) "such addressable

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[162]47 U.S.C. § 543(c), (1)(2). Of course, another crucial difference is that regulation of cable programming service takes place at the Commission level, and only upon a valid complaint of unreasonable rates from a subscriber or relevant state or local government authority. Id. at § 543(c)(1), (2).

converter box or other equipment as is required" for a basic-only subscriber to receive programming on a per channel or per program basis pursuant to Section 623(b)(8) (i.e., without being required to "buy through" intermediate service tiers).[163] If Congress intended all equipment to be priced based on actual cost, there would have been no need to specify that rates applicable to descrambling equipment used to receive pay services by a basic-only subscriber should be reviewed on the basis of actual cost, because such equipment would have been included. Rather, Congress must have intended that equipment used to receive premium service as well as basic service, except in the limited situation of a basic subscriber receiving pay services without intervening non-basic tiers and taking advantage of the 1992 Cable Act's anti buy-through provisions, need not be evaluated on the basis of actual cost. There is simply no other logical way to read the foregoing provisions of the 1992 Cable Act.[164]

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[163] Id. at § 543(b)(3)(A) (emphasis added).

[164] Moreover, a cable operator who charges a different price to non-basic or pay subscribers for converter box equipment does not violate the Act's uniform rate structure provisions, 47 U.S.C. § 543(d), since all subscribers who request the same service in the same geographic area will still be charged the same rate. See also Senate Report at 76 (uniform rate structure is intended to prevent cable operators from charging different rates in different geographical areas of the franchise). Subscribers who request different services, however, which require different uses of the converter box, may be charged different rates. In addition, this practice would not violate the non-discrimination clause of the 1992 Cable Act's anti buy-through prohibition, since there would be no discrimination as to "rates charged for video programming." 47 U.S.C. § 543(b)(8)(A).

It should be noted that the change in language regarding equipment rate regulation between the original House bill (which dealt with "equipment necessary for subscribers to receive the basic service tier")[165] and the 1992 Cable Act (which mentions "equipment used by subscribers to receive the basic service tier")[166] is not substantive. Rather, the change was made for two reasons: (1) to mirror the equipment language included in the 1992 Cable Act's "cable programming service" definition ("equipment used for the receipt of such video programming"),[167] and (2) to "give[] the FCC greater authority to protect the interests of the consumer."[168] There is no evidence to suggest the revision was made to mandate an interpretation which would potentially expose the vast majority of the equipment offered by cable operators to the actual cost standard. First, virtually all cable equipment is capable of receiving signals for basic, non-basic, and pay programming. Second, in answer to the Notice's question whether equipment exists that is designed to receive only certain types of programming, such as non-basic,[169]

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[165]See House Report at 83 (emphasis added).

[166]47 U.S.C. § 543(b)(3)(A) (emphasis added).

[167]Id. at § 543(l)(2) (emphasis added). As the Commission notes at note 94 of the Notice, Congress added installation and equipment to Section 623(c) at the same time that it changed "necessary" to "used" in Section 623(b)(3). Again, this demonstrates that Congress merely was attempting to harmonize these two sections.

[168]Conf. Report at 64.

[169]Notice at ¶ 65.

there simply is little or no such equipment on the market, nor has there ever been in an environment of multi-tier offerings. Such a situation would require that multiple converter boxes be placed in the homes of subscribers to multiple service tiers -- a very expensive and very consumer unfriendly consequence.

There is, moreover, precedent from the Commission and the U.S. Copyright Office for distinguishing among equipment offered by cable operators to subscribers based on the type of service to which the customer subscribes. For example, in a 1989 letter, the U.S. Copyright Office addressed a situation where a cable operator offers two levels of service, such as a limited basic containing all broadcast signals and an optional expanded tier of service. A simple converter was provided to the basic only subscribers at a one dollar monthly rental. A more sophisticated converter was provided to the expanded tier customers at a three dollar monthly rental. The Copyright Office ruled that only the one dollar rental fee need be included in gross receipts attributable to basic service for copyright purposes, not the full three dollar charge for the expanded tier converter, even though expanded tier customers also received the basic level signals as part of their overall package and such signals were processed by the three dollar converter.[170] Similarly, the Commission, in cases holding that cable operators could not

[170]Letter from Dorothy Shrader, General Counsel, U.S. Copyright Office, to James F. Ireland (Oct. 11, 1989) (on file with the U.S. Copyright Office).